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Proposition One: The Circuit Court of Appeals, after rejecting the trial court's finding that the 18-⅛% beneficial interest in the Trust was a gift to Doneghy, was bound either to remand the case for further and corrected findings by the trial court or, if it undertook to make its own findings was bound by facts averred and admitted in the pleadings and undisputed by anything in the record 41

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In the Supreme Court of the United States

OCTOBER TERM, 1941

NO. . . . . .

JAMES DONEGHY and ST. LOUIS UNION TRUST COMPANY,
Residuary Trustees Under Item 23 of the Last
Will and Testament of James C.
Doneghy, Deceased,
Petitioners,

VERSUS

ACEL C. ALEXANDER, Formerly Collector
of Internal Revenue,
Respondent.

NO. . . . . .

JAMES DONEGHY and ST. LOUIS UNION TRUST COMPANY,
Residuary Trustees Under Item 23 of the Last
Will and Testament of James C.
Doneghy, Deceased,
Petitioners,

VERSUS

H. C. JONES, Collector of Internal Revenue,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

TO THE HONORABLE SUPREME COURT OF THE UNITED STATES:

Your petitioners respectfully show:

I.

SUMMARY STATEMENT OF MATTER INVOLVED

These cases originated in the United States District Court for the Western District of Oklahoma. They are suits to recover income taxes paid for the year 1930 and present precisely the same questions of law upon the same state of facts. The only reason for two lawsuits in the place of one is that part of the tax sought to be recovered was paid to respondent Alexander, then Collector of Internal Revenue for the District of Oklahoma, and the other part of it was later paid to respondent Jones, Alexander's successor in office. The cases were consolidated for trial in the district court and were decided upon one findings of fact and decision, although a separate judgment was entered in each case. On appeal to the Tenth Circuit Court of Appeals they were consolidated for hearing, argument and decision and one record was printed for both cases and one opinion in them was delivered by the court, although a separate decision and judgment was entered in each case. The Alexander case was No. 5644-Law in the district court and No. 2157 in the Circuit Court of Appeals and the Jones case was No. 5699-Law in the district court and No. 2158 in the Circuit Court of Appeals. Both cases were commenced by J. C. Doneghy, but he died while they were pending in the district court and the present petitioners by appropriate substitution were made plaintiffs in that court.

In some instances the name *Doneghy,* and the term *taxpayer* having reference to Doneghy, as used herein mean the

plaintiffs and petitioners. This meaning will appear from the context. All italics herein are ours unless otherwise indicated.

The facts may be summarized as follows:

On February 17, 1904, the Doneghy Investment Company, herein referred to as the Company, was incorporated under the laws then in force in Indian Territory. Its authorized capital was $100,000 which was divided into 4,000 shares of a par value of $25.00 each. One of its corporate purposes was to purchase, acquire, hold, rent, sell and convey land, and particularly Indian lands in the Indian Territory, and rights and interests therein (R. 42).

It was organized on February 23, 1904, by the election of directors and officers, and J. C. Doneghy was elected president and treasurer. Eighty thousand dollars in cash was paid in for 3,200 shares of its capital stock at or about the above date and no further sum was ever paid in on account of capital and no additional shares of stock were ever issued. Doneghy paid in $51,000 and acquired 2,040 shares, being 51/80 or 63¾% of all of its issued stock, and owned this amount continuously to April 26, 1915, when it was liquidated and all of its assets and property were distributed in liquidation (R. 42).

Upon the organization of the Company the directors by resolution authorized Doneghy as its president to make bids on Indian land and to sign and execute all papers necessary to purchase land offered for sale by the allottee or any other person through the Indian agent or any other agent or

owner of lands for the Company and also to make and sign deeds for land sold by the Company and to execute and sign any instrument that was necessary to transact business for it.

In respect of the compensation to be paid Doneghy for his services the resolution, adopted February 23, 1904, provides as follows:

> "On this proposition it was agreed and understood that the compensation of J. C. Doneghy as President and Manager of the Company was as follows:
>
> "He is to receive no salary, but is to be paid his actual expenses incurred in behalf of the Company, and then to receive ½ of all the net profits of all transactions." (R. 43.)

Under these resolutions the entire management and control of the business and affairs of the Company was turned over to Doneghy and he continued in the management of it for the compensation for his services fixed in the foregoing resolution until the Company was liquidated on April 26, 1915.

Beginning at least as early as January 1, 1912, and including January 1, 1919, he made an annual inventory and appraisal of all the assets of the Company and of its successor, the J. C. Doneghy Trust hereinafter referred to, for the purpose of keeping an accurate record of the properties of the Company and of the Trust and their values for his own information. Each of these was made at the beginning of a calendar year except the one for 1913, which was made on March 1, 1913 (R. 48-50).

The first Legislature after the erection of the State of Oklahoma enacted a law requiring all corporations doing business in the State, with certain exceptions which did not include the Company, to dispose of all real estate then owned by such corporations within seven years from May 26, 1908. (Oklahoma Session Laws, 1907-8, p. 197.) In order to comply with this statute the directors of the Company with the written consent of all the stockholders by resolution adopted April 26, 1915, authorized and directed the conveyance of all its lands to Doneghy to be held and disposed of by him in accordance with a trust agreement entered into between him and the stockholders on the same day. The consent and agreement referred to was made by all the other stockholders as parties of the first part with Doneghy as party of the second part and provides as follows:

> "That parties of the first part have consented that Doneghy Investment Company, shall make a conveyance of all the lands held by said corporation in compliance with the laws of Oklahoma requiring that corporations shall dispose of all lands within seven years from May 26, 1908, and that said lands shall be conveyed by Warranty Deed to said J. C. Doneghy, party of the Second Part.
>
> "That said second party shall as soon as he can do so, sell said land and make conveyance of same as to him may be deemed for the best interest of the parties hereto.
>
> "That said second party shall first deduct all his actual expenses incurred in behalf of the Doneghy Investment Company, and in the sale of this land, not heretofore received by him, and then to deduct for his services one-half of the net profits from the sale of said

lands; and pay out the remainder of said amount received from the sale of said lands as follows: A. G. Edwards & Sons, one-tenth, Edward Hidden, one-tenth, B. F. Edwards, one-tenth, John H. Carroll, one-sixteenth, and J. C. Doneghy, 51/80.

"For and in consideration of the benefits to be derived from this agreement, the parties hereto hereby agree to warrant the title to said lands to be sold, as their interest in said corporation appears." (R. 45.)

The resolution of the Board of Directors referred to provided as follows:

"Pursuant to an agreement among all the stockholders hereto attached, the following resolution was introduced and upon motion duly made and seconded, was unanimously adopted, to-wit:

"Resolved, That in order to comply with the laws of the State of Oklahoma, requiring all corporations to dispose of all lands within seven years from May 26, 1908, and in compliance with an agreement between the stockholders of this company and J. C. Doneghy, that the President of Doneghy Investment Co., be authorized and directed to convey all the lands of the Doneghy Investment Company with good and sufficient warranty deed to J. C. Doneghy for such consideration as he may deem sufficient and proper. Said real property and premises are to be held and disposed of by said J. C. Doneghy in accordance with an agreement entered into between the stockholders and J. C. Doneghy, said agreement being dated the 26th day of April, 1915." (R. 46.)

Pursuant to such consent, resolution and contract, the Company liquidated and conveyed all of its assets consisting of the lands which it then owned to Doneghy in trust

for the purpose and for the beneficiaries stated. This was the formation of the J. C. Doneghy Trust, herein referred to as the Trust, which is involved in these proceedings. (R. 42-43.)

It will be noted that none of the Company's land was conveyed to Doneghy in severalty and by title in his own right as compensation for services rendered under the contract of February 23, 1904. His 50% of the Company's lands in excess of $80,000 in value was deemed received by him in liquidation and reinvested in the Trust, which took over and held the Company's assets subject to the same rights and interests of the individuals therein as these had been subject to in the hands of the Company. Thereafter, as before, Doneghy was to receive "one-half of the net profits from the sale of said lands" for services and 51/80 or 63¾%, being his proportion of stock ownership in the Company, of the remainder.

The fair market value of these lands at April 26, 1915, as established by the testimony and inventory and appraisal of Doneghy was $531,819.58. This value was admitted by the defendant in his requested finding of fact No. 17 (R. 19) and found by the court to be correct (R. 27, 29). The court further found that this property had the same fair market value on March 1, 1913, that it did on April 26, 1915. The court said:

> "The defendant in his requested findings of fact, (Number 21) [17] admits that the inventory value of the assets acquired by the trust at the date of its creation on April 26, 1915, was $531,819.58 *and that said sum represented the fair market value of the trust as of*

the date of its creation. From the record in this case, the court finds that said sum of $531,819.58 was the fair market value of the property on March 1, 1913, as there is no indication of a change in the value during that period." (R. 27.)

As trustee of the Trust Doneghy continued in control and management of its property and estate from April 26, 1915, until after the calendar year 1930, the taxable year here involved.

On March 18, 1918, all the beneficiaries of the Trust, including Doneghy, entered into a supplemental trust agreement in which all the other beneficiaries were first parties and Doneghy second party. This supplemental agreement provided as follows:

"That parties of the first part have consented that Doneghy Investment Company, Doneghy Oil Company and Pioneer Land Co., of Muskogee, Oklahoma, shall make a conveyance of all the lands and property held by them in compliance with the laws of Oklahoma, requiring that corporations shall dispose of all lands within seven years from May 26, 1908; and that said lands and property shall be conveyed by warranty deed to said J. C. Doneghy, party of the second part.

"That said Second Party may sell said land and property and make conveyance of same as to him may be deemed for the best interest of the parties hereto; and may during the period of said sale, with the proceeds, purchase and sell other lands and oil leases, provided it is in his judgment for the best interest of said parties.

"That said second party shall first deduct all his actual expenses incurred in behalf of the Doneghy Investment Company, Doneghy Oil Company, Pioneer

Land Company, and in the sale of the land, leases and reservations so held by him under this trust, and then pay to the parties hereto the sum of $80,000.00, according to their interests in the Doneghy Investment Company, being the amount originally invested in the stock of the Doneghy Investment Company. After said sum has been paid to the parties hereto, then the interests of said parties in the balance of the land, leases, reservations and other property held or acquired by said second party for this trust, shall be as follows: A. G. Edwards Sons 5%, Edward Hidden 5%, B. F. Edwards 5%, J. H. Carroll 3⅛%, J. C. Doneghy, 81⅞%, and upon this basis shall all future distributions be made, after deducting all actual expenses as aforesaid." (R. 47.)

The Doneghy Oil Company and the Pioneer Land Company referred to were subsidiaries of the Doneghy Investment Company and whatever lands stood in the name of these corporations belonged to Doneghy Investment Company and were included in the *corpus* of the trust created by the agreement of April 26, 1915, in compliance with the laws of Oklahoma requiring corporations to dispose of their land within seven years from May 26, 1908.

It will be observed that after the execution of said supplemental agreement of March 18, 1918, Doneghy had precisely the same interest in the property of the Trust, if it had then liquidated at its fair market value, that he had in the property of first the Company and then the Trust on April 26, 1915, if this property had then been distributed in severalty to the natural persons entitled to receive it and the enterprise finally wound up. The Company's total cost in its

property was its paid-in capital of $80,000. All it ever accumulated in excess of that sum was profit. If either on March 1, 1913, or at its liquidation on April 26, 1915, it had converted its lands into cash at their fair market value of $531,819.58 and had distributed this sum under the agreement of February 23, 1904, the distribution would have been as follows:

Amount to be distributed		$531,819.58	
Less cost (original capital investment)		80,000.00	
Net profits		451,819.58	
One-half of net profits to Doneghy for services		225,909.79	$225,909.79
Other half of net profits	$225,909.79		
Plus original investment	80,000.00		
Amount to be distributed to stockholders		305,909.79	
63¾% (51/80) to Doneghy as stockholder	195,017.49		195,017.49
36¼% (29/80) to other stockholders	110,892.30	305,909.79	
Total to be received by Doneghy			$420,927.28

The fair market value of the property of the Trust at March 18, 1918, was substantially the same as at April 26, 1915, and March 1, 1913 (R. 50), and if it had been converted into cash and distributed after and under the provisions of that agreement, the distribution would have been as follows:

Amount to be distributed	$531,819.58
Less original investment first deducted	80,000.00
	451,819.58
81⅞% of $451,819.58 to Doneghy	369,927.28
63¾% (51/80) of $80,000.00 to Doneghy	51,000.00
Amount to be received by Doneghy	$420,927.28
Amount to other beneficiaries	$110,892.30

It is plain that 50% of all net profits of the Company or of the Trust, plus 63¾% of its remaining assets, at April 26, 1915, or at March 18, 1918, and 63¾% of $80,000 plus 81⅞% of the remainder are exact mathematical equivalents. By the 1918 agreement Doneghy did not acquire anything that he was not entitled to receive before and the other beneficiaries of the Trust did not part with anything which they were entitled to retain, and all of them understood that they were settling and rearranging their property interests according to their contract rights.

Although Doneghy was not to receive his share of the net profits for services except as profits were realized through the sale of lands, yet he had the vested right to have the lands which represented accumulated profits converted into money and his share of the profits thus realized paid to him whenever the whole enterprise was finally liquidated, unless he and the others should agree that he might take his share of the net profits in land instead of money. So when in 1918 the other beneficiaries transferred one-half of their percentages of interest in the Trust to him, this satisfied all his claim against accumulated profits of the Trust for services, and thereafter, instead of having an interest of 50% in the profits realized by the Trust and

63¾% of the remainder, he had 81⅞% of all the Trust after distributing the $80,000 originally invested. Thus the agreement of March 18 merely changed Doneghy's claim against the Trust for compensation for services into a percentage of beneficial interest in the Trust without gain or loss to any party.

Doneghy made an income tax return for all years (R. 25) and his returns for 1915 and 1918 are in evidence (R. 73-80, 87-89). On his 1915 income tax return he reported $20,000 on the line for "Salaries and wages." He did not on either return report any income derived from liquidation of the Company or from the acquisition of a larger beneficial interest in the Trust. On his return for 1918 he showed and paid a tax of $1,060.23, but this return was reviewed and audited by the Commissioner and additional tax of $4,431.49 and a 5% penalty of $221.57 was assessed, apparently under date of May 3, 1921 (R. 87). There was much evidence introduced upon the trial in respect of the investigation by a revenue agent of Doneghy's income tax liability for 1918 and the auditing of his return, especially with reference to the question of whether depletion on oil properties of the Trust was allowable to the Trust or to him to the extent of his beneficial interest in it. In preparing the record under paragraphs (a), (d) and (c) of Rule 75 of the Federal Rules of Civil Procedure, this was deemed not essential to the questions presented on appeal and was omitted.

The value of the 18⅛% interest in the corpus of the Trust acquired by Doneghy in 1918 in exchange for his right to share in its profits was $96,836.98 (R. 31). There was

only a nominal increase in the assets of the Trust between April 26, 1915, and March 18, 1918.

On June 30, 1930, Doneghy sold to James Doneghy, a nephew, a 25% beneficial interest in the Trust, being 30.534351% of the 81⅞% beneficial interest therein then owned by him, for the price of $62,500 (R. 48). After the formation of the Trust in 1915, and in fact between 1918 and 1930, distributions were made to the beneficiaries which exceeded earnings and were in part distributions from the capital or corpus of the trust estate transferred to it upon its creation in 1915. The amount of these capital distributions as fixed by the court was $91,519.88 (R. 28, 29) in which was included the $80,000 original investment in stock of the Company.

On his return for 1930 Doneghy claimed a cost in the 25% beneficial interest in the Trust which he sold to James Doneghy of $94,350.66, and upon deducting the sale price of $62,500 for that interest, determined a net loss on the sale of $31,850.66 (R. 55, Schedule D). After filing the return an investigation of his income tax liability for 1930 was made by a revenue agent. In the report of his investigation the agent disallowed the loss claimed by Doneghy on the sale of the 25% beneficial interest and determined that, instead of sustaining a loss, he had realized a gain on that sale. This result was arrived at by revising and reducing the fair market value of the assets of the Company transferred upon its liquidation through its stockholders to the Trust and disallowing any cost in the 18⅛% interest in the trust estate placed in Doneghy by the agreement of

1918, whether this was to be deemed as acquired in 1915 or in 1918.

Since the cases have different numbers in the district court and in the Appeals Court and in this Court, they will, to avoid confusion, be referred to as the Alexander case and the Jones case.

The petition in the Alexander case alleges grounds of jurisdiction and the office of the defendant as a former Collector of Internal Revenue; that the taxpayer erroneously reported a net income of $72,137.21 on his return for 1930 and computed and paid the tax due thereon; that by inadvertence and mistake in the preparation of his return he claimed and took a deduction from gross income thereon of a loss of only $31,850.66 on the sale of a 25% beneficial interest in the J. C. Doneghy Trust, while in truth and in fact the loss he sustained on that sale was $47,574.92, or $15,724.26 greater than that claimed and taken; that such erroneous understatement of that loss deduction resulted in an overpayment of tax in the sum of $1,965.53; that the tax computed to be due and assessed on his return was $12,-144.25, which he paid in four equal installments on March 6, June 1, September 2 and December 3, 1931; that on February 17, 1933, he filed with the Commissioner of Internal Revenue a claim for refund of all of the above amount of tax paid by him and on June 11, 1934, filed an amended claim for refund thereof based on the same grounds as those alleged in his petition for his right to recover; and that these claims were in due course rejected by the Commissioner.

He prays for recovery of $1,965.53 with interest from the dates of payment as provided by law (R. 97-99).

In the Jones case the petition alleges grounds of jurisdiction and the office of the defendant as Collector of Internal Revenue and the same facts with respect to error in the plaintiff's original return for 1930, due to the understatement by inadvertence and mistake of the loss sustained on the sale of a beneficial interest in the Trust, which are alleged in the Alexander case. Then it further alleges that following an investigation and report by a revenue agent of the taxpayer's income tax liability for the year 1930, the Commissioner determined a deficiency in his income tax for that year of $7,638.20; that upon being notified by letter from the Commissioner of the determination of such deficiency and on June 11, 1934, he paid the amount thereof to the defendant as Collector with interest thereon of $1,-483.09, making a total payment of tax and interest of $9,-121.29; that this sum was erroneously, wrongfully and illegally collected, and on December 28, 1934, he filed with the Commissioner a claim for refund of it, based on the same grounds as those set forth in his petition for a recovery; and that thereafter his claim was in due course rejected by the Commissioner. He prays for recovery of $9,121.29 with interest from June 11, 1934 (R. 6-8).

The defendant in each case by his answer admitted the jurisdictional matter and his position as Collector, the payment of the stated amounts of tax and interest to him, the filing of a claim for refund by the plaintiff and the rejection thereof as in the petition alleged, but denied that the

plaintiff sustained a loss in any amount on the sale of a beneficial interest in the Trust, and averred that instead he realized a taxable gain of $29,255 on that sale and that the original tax and the deficiency in tax and interest were rightfully and legally assessed and collected (R. 99-100, 8-10).

To these answers the plaintiff filed in each case a reply of general denial of all matter in conflict with the allegations of the petition (R. 9, 101).

On the day the cases were called for trial the defendant in each case filed an amendment to his answer setting up a new defense. This amendment is in identical language in each case as follows:

> "As a separate and distinct defense in this action, defendant alleges:
>
> "That the plaintiff is estopped to deny that the original cost basis of his interest in J. C. Doneghy trust is the amount of $51,000 and no more because of the following facts and circumstances:
>
> "That prior to March 1, 1913, plaintiff acquired stock in Doneghy Investment Company, a corporation organized in 1904 under the laws of Indian Territory, at a cost to him of $51,000. That plaintiff's cost basis in this stock was no greater than $51,000 on March 1, 1913. That on April 26, 1915, Doneghy Investment Company was liquidated and plaintiff as the owner of 63¾% of the stock of the corporation received 63¾% of the corporation's assets. That plaintiff did not report for income tax purposes on his 1915 income tax return or on any subsequent income tax return any taxable gain as a result of this transaction. That as a result of plaintiff's own omission to report any taxable gain in

1915 by reason of this transaction the taxable gain realized by plaintiff at that time has wholly escaped taxation. That the period within which the Commissioner of Internal Revenue might assess a deficiency tax against the plaintiff for the year 1915 expired long prior to 1930. *That through an exchange of his share of the proceeds of the liquidation of Doneghy Investment Company plaintiff acquired the interest in the J. C. Doneghy trust held by him from April 26, 1915, until 1930, during which latter year the plaintiff sold a portion of his interest in the trust.*" (R. 10-11, 102-103.)

To this the plaintiffs replied in each case with a general denial and further as follows:

"That they admit that J. C. Doneghy, the original plaintiff herein and now deceased, acquired stock prior to March 1, 1913, in Doneghy Investment Company, a corporation organized in 1904 under the laws of Indian Territory, at a cost to him of $51,000.00, and they aver that he acquired said stock on February 23, 1904, and further aver that the total paid in capital of said corporation was $80,000 evidenced by 3200 shares of the par value of $25.00 a share, of which J. C. Doneghy then acquired 2040 shares, or 63¾% of the total issued stock of the corporation, but they specifically deny that his cost basis in this stock was no greater than $51,000 on March 1, 1913.

"III.

"That they admit that on April 26, 1915, Doneghy Investment Company was liquidated and that J. C. Doneghy, as the owner of 63¾% of the stock of that corporation, received 63¾% of its assets which were distributable to its stockholders on liquidation, and they aver that he also received one-half of all property and assets which it then owned in excess of $80,000 in value

as compensation for services rendered it by him during the period from February 23, 1904, to April 26, 1915, but they do not have knowledge whether he failed to report for income tax purposes on his 1915 income tax return any taxable gain as a result of that transaction and so they deny that he did not report any such taxable gain on his income tax return for 1915, and they aver that he did not in any event have any taxable gain as a result of that transaction in 1915, and they admit that the period within which the Commissioner of Internal Revenue might assess a deficiency against him for the year 1915 expired long prior to 1930.

"IV.

"*That they admit that it was through an exchange of his share of the proceeds of the liquidation of Doneghy Investment Company,* including the portion of such proceeds distributed to him in compensation for services as above set forth, *that J. C. Doneghy acquired the interest in the J. C. Doneghy Trust held by him from April 26, 1915, until 1930, in which year he sold a portion of his interest in said trust.*" (R. 12-13, 103-104.)

The trial court found for the plaintiffs on all issues except as to the inclusion in the cost basis of Doneghy's beneficial interest in the Trust, a part of which he sold in 1930, of the 18⅛% interest acquired in 1918. He found that this was a gift or donation from the other beneficiaries to Doneghy and concluded as a matter of law that, because it was a gift, Doneghy had no cost in it that would be deductible from the sale price to determine gain or loss on a sale. He made no specific finding against the affirmative defense of estoppel plead by the defendants, but his finding and conclusion that Doneghy had a cost basis of 63¾% of the value

of the property transferred from the Company to the Trust in 1915 (R. 27, 29) necessarily negatives that defense.

Reference is here made to such findings of the trial court as are deemed pertinent to the errors complained of.

The court found that:

> "Doneghy made his personal income tax reports regularly for all of the years after the enactment of the income tax law until 1930 and in these various reports he included the income that he had actually received from the Doneghy trust." (R. 25.)

Then the court states what he says is the contention of the taxpayer (R. 26). This statement is correct, *except that the taxpayer did not contend that Doneghy's interest in the assets transferred from the Company to the Trust was 51/80 or 63¾%, and hence only $339,034.98.* The taxpayer's contention was and is that Doneghy's interest in those transferred assets, and hence his interest in the assets constituting the corpus of the Trust, *was 50% of the amount of all thereof in excess of $80,000 and 63¾% of all the remainder, and hence $420,927.28* (page 10, *supra*), *instead of only $339,034.98 as stated by the court.*

Then the court found further as follows:

> "The trust agreement continued the arrangement that was made in 1904 of paying the taxpayer, as manager of the Trust, his actual expenses and one-half of the net profits from the sale of the lands. The only provision for distribution was after the sale of lands and there was no provision for vesting in the taxpayer an undivided one-half interest in the accumulated profits resulting from an increased value of the lands. In other

words, before there could be any distribution of profits, a sale must have been made. The taxpayer, according to the records, received his one-half of the net profits from the sales of land until 1918." (R. 27.)

The petitioners regard this as a correct statement of fact, but point out that, even though there was no provision for distribution of profits until realized by the sale of lands of the Company and later of the Trust, still since the Company had accumulated a surplus of $451,819.58 at March 1, 1913, and had this surplus on April 26, 1915, in the form of land, Doneghy could not be deprived of his contractual right to have this surplus converted into money and his share of the profits thus realized distributed to him whenever the whole enterprise was liquidated, but the Company only, and not the whole enterprise, was liquidated when its assets were transferred to the Trust as a substitute for it.

The petitioners maintain there is no significance in the admitted fact that Doneghy received his share of net profits from the sales of land as these were made and net profits realized and distributed to the interested parties according to their respective rights and interests until 1918 (R. 27).

The court found that the value of the property transferred by the Company to the Trust in 1915 was $531,819.58 and that this property had the same value in the hands of the Company on March 1, 1913 (R. 27).

The court said:

"Doneghy made his income tax reports regularly from 1915 to 1930, but at no time did he ever assert that he had made an additional capital investment in the trust

with which to pay for the additional 18⅛ per cent." (R. 27.)

There is no significance in the statement that Doneghy did not in his income tax reports show an additional capital investment in the Trust with which to pay for the additional percentage of interest acquired therein in 1918. There is no requirement, and no reason outside of any requirement, for a taxpayer to report his capital investments on his income tax return. Income tax returns deal with income and deductions and not with capital investments.

Then the trial court said:

> "It is the contention of the taxpayer that this 18⅛% was given to him because of services rendered and to be rendered. The trust agreement of 1918, however, did not make any such provision but made provision for paying the expenses from the sales of lands or properties belonging to the trust, and there is nothing in the record to indicate that the taxpayer did not receive his full one-half of the net profits from sales of trust property until 1918." (R. 27-28.)

This is not an entirely accurate statement of the taxpayer's contention in this respect. His contention was and is that he had earned under his contracts first with the Company and then with the Trust the right to share in accumulated profits when realized by sales as compensation for services and that this right still existed in 1918. At that time the parties, instead of selling the Trust property and realizing the accumulated profits in money and distributing the money, by voluntary agreement distributed to Doneghy in property the amount that would have been distributable to

him in money, if the property had been converted into money at its then fair market value. The 1918 agreement was merely a method of paying an indebtedness of the Trust to Doneghy which all the parties recognized.

It is again pointed out that the fact that the taxpayer may have received, and presumably did receive, his full one-half of the net profits from the sales of Trust property until 1918 has no significance or relation to the division of accumulated profits in the form of property made by the 1918 agreement in lieu of converting the property into money and distributing the money.

Then the trial court said:

> "There was apparently no consideration for this additional interest other than the fact that the minority holders of interests in the trust had already received almost twice the amount of their original investment. The estate, including the year 1930, had paid in dividends, $1,072,000." (R. 28.)

Of course the holders of interests in the Trust could not know in 1918 what amount of dividends would be paid by the end of 1930. And the court specifically found that Doneghy included in his returns until 1930 all the income that he received from the Trust (R. 25).

In the statement last quoted the court ignores the averment in the defendant's answer and the admission thereof in plaintiff's reply:

> "That through an exchange of his share of the proceeds of the liquidation of Doneghy Investment Company plaintiff acquired the interest in the J. C. Done-

ghy Trust held by him from April 26, 1915, to 1930, during which latter year the plaintiff sold a portion of his interest in the trust." (R. 10-11, 102-103, 12-13, 103-104.)

Then the court concludes as a matter of law that the 18⅛% additional interest in the Trust acquired by the taxpayer in 1918 was without consideration and was a gift or donation to him by his associate beneficiaries under the Trust (R. 28).

By an amendment to this conclusion of law, which was really in the nature of a further finding of fact, the court added the folowing:

"The fair market value of this additional interest of 18⅛% so acquired by the taxpayer by gift or donation was $96,836.98 when acquired." (R. 31.)

Then the court in its third conclusion of law made a computation to determine the loss to the taxpayer on the interest in the Trust sold in 1930. The method of this computation is correct, but the court erred in that he did not recognize that Doneghy was entitled to any part of the accumulated profits of the Company in 1915 or of the Trust in 1918 as compensation for services. Then, treating the 18⅛% interest in the Trust as a gift to Doneghy in 1918, the court further erred in not recognizing its fair market value at that time as Doneghy's cost basis in it.

The Circuit Court of Appeals, after rejecting as erroneous the trial court's finding that the 18⅛% of additional interest in the corpus of the Trust transferred to Doneghy in 1918 was a gift from the other beneficiaries, made its own

findings of fact on the record, which showed on its face that it included only a portion of the evidence and proceedings upon the trial (R. 42), and affirmed the judgment of the trial court on two alternative grounds (R. 114-115).

In the opinion it makes the following erroneous statement of the petitioner's contention:

> "The major contention of plaintiffs is that from the formation of the trust in 1915 to the execution of the agreement in 1918, the taxpayer owned 63¾% of $80,000 of the assets and 50% of the balance; that the 50% represented compensation for services rendered the trust."

The petitioners never contended that, either during the period of the Company or the period of the Trust, the taxpayer owned 63¾% of $80,000 of the Company assets or the Trust assets and 50% of the balance. Their contention was and is that during the period of the Company the taxpayer equitably owned, or the Company owed to him, 50% of all its assets in excess of $80,000 and 63¾% of the balance, being the other half of such excess plus $80,000, and that during the period of the Trust the taxpayer actually owned, or the Trust owed to him, one-half of all Trust assets in excess of $80,000 and 63¾% of the balance, being the other half of such excess plus $80,000. A mathematical computation will show that the amount of the interest claimed first in Company assets and then in Trust assets as thus stated, is a very different amount from that which would result upon the Court's statement of the plaintiff's contention.

And, regardless of the amount of the interest in the Trust claimed for the taxpayer, the Court's statement that plaintiffs contended that this "represented compensation for services rendered the trust" is also erroneous, for that their contention was that the taxpayer's right to a share in the assets of the Trust which was finally satisfied by the acquisition of an additional 18⅛% in the corpus of the Trust in 1918 represented primarily compensation for services from 1904 which were realized on liquidation of the Company in 1915 and reinvested in the Trust.

Then, since if the increased interest in the Trust was not a gift, there must have been a consideration for it, the Appeals Court says that the burden was on the plaintiffs to show what the consideration for it actually was, and that the record does not show that there was anything at all due to the taxpayer from the Trust in 1918, and that so far as the record shows he might have exchanged property or paid cash out of his pocket for the increased interest. Then the Court concludes that the judgment of the trial court should be affirmed, because the petitioners failed to carry the burden of proof resting upon them to show what consideration the taxpayer actually paid for the increased interest.

In this the Appeals Court has utterly ignored the averment in the defendants' answers and the admission thereof in the plaintiffs' replies:

> "That through an exchange of his share of the proceeds of the liquidation of Doneghy Investment Company plaintiff acquired the interest in the J. C. Doneghy Trust held by him from April 26, 1915 until 1930." (R. 11, 12, 102, 104.)

It was because facts averred in the pleadings of one party specifically admitted to be true in the pleadings of the adverse party are, under the most elementary rules and in all jurisdictions, to be taken as true, that evidence introduced upon the trial to the effect that there was no consideration paid by the taxpayer outside of whatever claim he had against the Trust under the contracts of February 23, 1904, and April 26, 1915, for the increased interest acquired in 1918, was omitted from the record on appeal.

Then as an alternative the Appeals Court held that as a matter of fact and law the judgment of the trial court should be affirmed on the ground that Doneghy was estopped to claim any cost basis in the increased interest acquired in 1918 to determine the amount of the loss on the sale of an interest in 1930.

The only estoppel plead by the defendants was in respect of the year 1915 and the only fact averred to establish an estoppel in any year was that the taxpayer omitted to show on any return any gain realized on liquidation of the Company (R. 11, 102). They averred that the cost basis of Doneghy's stock on liquidation of the Company in 1915 was the $51,000 which he had originally paid in, and that all that he realized on such liquidation in excess of the $51,000 was taxable gain to him in that year (R. 11, 102). The trial court made no specific finding on the issue of estoppel, but did find and allow a cost of $339,034.98 in the interest acquired by Doneghy in the corpus of the Trust in 1915. This was in effect both a finding of fact and conclusion of law

that the defendants had not sustained their defense of an estoppel.

The Appeals Court held that if the increased interest in the Trust acquired in 1918 was to be deemed compensation for services, regardless of when rendered, then it represented earnings realized in that year and the value of that interest was taxable gain to the taxpayer, and that, upon the solitary fact and no other that it was not included in income on his return for that year, the estoppel plead by the defendants in respect of the year 1915 applied to the year 1918 and was established by the evidence, and that the judgment of the trial court would be affirmed on that ground.

II.

JURISDICTION

1. The date of the judgment of the Circuit Court of Appeals to be reviewed is March 6, 1941 (R. 115-116). The opinion of the Court was handed down on the same day (R. 111).

2. The statutory provision under which the jurisdiction of this Court is invoked and which is believed to sustain its jurisdiction is Section 347(a) of Title 28 of the United States Code, being Section 240 of the Judicial Code, as amended.

3. The decision of the court below is in conflict with the decisions of various Circuit Courts of Appeals and of this Court and decides an important question of Federal law which apparently has not been, but should be, settled

by this Court and is such a departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. This Court entertains jurisdiction to grant writs of certiorari in similar cases at every term, and there can be no need to list any of the great array of cases in which its jurisdiction is so exercised.

4. The petition for the writs is presented under Rule 38, paragraph 5(b), of the Revised Rules of this Court adopted February 13, 1939, and effective February 27, 1939.

III.

QUESTIONS PRESENTED

The questions presented on this petition may be broadly stated as follows:

1. Can the Circuit Court of Appeals, on these appeals in law actions tried to the Court, after setting aside under Rule 52(a) of the Federal Rules of Civil Procedure the fact finding on which the trial court based its judgment, make its own fact findings on questions not passed on or passed on adversely by the trial court and thereon affirm the judgment of the trial court?

2. If the foregoing question is answered in the affirmative, can the Circuit Court of Appeals make a finding that a fact specifically averred in the pleading of one party, and expressly admitted in the pleading of the adverse party is not established as a fact for want of evidence and thereon affirm the judgment of the trial court?

3. Where a transcript of only that portion of the proceedings and evidence in the trial court deemed essential to the decision of the questions presented by the appeal is brought up in the record on appeal under paragraphs (a), (d) and (e) of Rule 75 of the Federal Rules of Civil Procedure, can the Circuit Court of Appeals, after setting aside the fact finding on which the trial court based its judgment, make its own fact findings on such portion of the proceedings and evidence before it on questions not passed on or passed on adversely by the trial court and thereon affirm the judgment of that court?

4. Are the facts in the record before the Circuit Court of Appeals in these cases upon any view of them sufficient as a matter of law to sustain the estoppel plead by the defendants?

IV.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRITS

1. The Circuit Court of Appeals, in holding that there was no proof in the record that the increased interest in the trust estate transferred to the taxpayer in 1918 was compensation for services rendered to the Doneghy Investment Company from 1904 to 1915, and in also holding that the record did not show for what consideration he acquired that interest, has disregarded the fact averred by defendants and admitted by plaintiffs in their respective pleadings that it was "through an exchange of his share of the proceeds of

the liquidation of Doneghy Investment Company" that he acquired all the interest in the Trust that he held from April 26, 1915, until 1930, and has rendered a decision in conflict with the elementary rule that facts averred in the pleadings of one party and admitted in the pleadings of the adverse party are established facts in the case and in conflict with all court decisions in every jurisdiction on that subject, and in rendering such decision has so far departed from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.

2. The Circuit Court of Appeals in deciding that, after setting aside as clearly erroneous the finding of the trial court that the increased interest in the trust estate transferred to the taxpayer in 1918 was a gift, it could and would, notwithstanding these were law actions tried to the court without a jury, make its own findings as to the facts which the record proved or failed to prove and render a decision on its own findings, where a transcript of only that portion of the evidence and proceedings upon the trial deemed sufficient to show the error of the trial court was brought up in the record under paragraphs (a), (d) and (e) of Rule 75 of the Federal Rules of Civil Procedure, instead of remanding the case to the trial court for corrected and further findings, has rendered a decision in conflict with the purpose and intent of said paragraphs of said Rule 75 and in conflict with Rule 52(a) of said Federal Rules of Civil Procedure and in conflict with the decisions of this Court in *McCaughn* v. *Real Estate Land Title Trust Co.*, 297 U. S.

606, 608, and *State Farm Mut. Aut. Ins. Co.* v. *Coughran*, 303 U. S. 485, 487, and cases cited in those cases, for even though the holding in those cases is deemed modified by said Rule 52(a) to the extent that the Appellate Court in a law action tried to the court without a jury may set aside a clearly erroneous finding of the trial court, still the Appellate Court is without power to make its own findings on questions on which the trial court made no finding and on such findings of its own to affirm the judgment of the trial court.

3. The Circuit Court of Appeals, in deciding that the mere omission by the taxpayer from gross income on his return of the fair market value of the increased interest in the trust estate transferred to him in 1918, assuming it was taxable income in that year, was sufficient, of itself alone and notwithstanding his return was audited and additional tax for that year assessed against him by the Commissioner, to sustain the defense of estoppel plead by the defendants in respect of the year 1915 against the taxpayer's claim that the fair market value of this increased interest in 1918 was includable in the cost basis of his entire beneficial interest in the Trust to determine his loss on the sale of a portion thereof in 1930, has rendered a decision in conflict with the decisions of the Circuit Court of Appeals of the Second Circuit in *Helvering* v. *Brooklyn City R. Co.*, 72 Fed. (2d) 274; *Salvage* v. *Commissioner*, 76 Fed. (2d) 112, and *Commissioner* v. *Union Pac. R. Co.*, 86 Fed. (2d) 637, and with the decision of the Circuit Court of Appeals of the Fourth Circuit in *Hull* v. *Commissioner*, 87 Fed. (2d) 260, and with the

decision of the Circuit Court of Appeals of the Eighth Circuit in *Crossett Lumber Co.* v. *United States*, 87 Fed. (2d) 930, and with the decision of the Circuit Court of Appeals of the Ninth Circuit in *Van Antwerp* v. *United States*, 92 Fed. (2d) 871, and with the decision of the Court of Appeals of the District of Columbia in *Louis Werner Saw Mill Co.* v. *Helvering*, 96 Fed. (2d) 539, and with the decisions of this Court in *Helvering* v. *Salvage*, 297 U. S. 106, and *McEachern* v. *Rose*, 302 U. S. 56, upon the same matter.

4. The Circuit Court of Appeals in deciding that, if the increased interest in the trust estate acquired by the taxpayer in 1918 was in settlement of his claim to compensation for services rendered, then the fair market value of that interest was includable in his gross income for that year under the provisions of Section 213 of the Revenue Act of 1918, 40 Stat. 1057, 1065, has rendered a decision in disregard of the fact that the right to that compensation had accrued to him prior to March 1, 1913, and in conflict with Articles 87 and 1548 of Treasury Regulations 45 as amended by Treasury Decision 3206, 5 Cumulative Bulletin 116 and 46, and with all subsequent Treasury Regulations on the subject and with the decision of the Circuit Court of Appeals of the Eighth Circuit in *Lynch* v. *Turrish*, 236 Fed. 653, and with the decision of this Court in *Lynch* v. *Turrish*, 247 U. S. 221, upon the same matter.

Wherefore, your petitioners pray that writs of certiorari under the seal of this Court directed to the United States Circuit Court of Appeals for the Tenth Circuit at

Denver, Colorado, commanding said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings of said Court had in case No. 2157, entitled *James Doneghy and St. Louis Union Trust Company, Residuary Trustees under Item 23 of the Last Will and Testament of James C. Doneghy, Deceased, Appellants,* v. *Acel C. Alexander, formerly Collector of Internal Revenue, Appellee,* and in case No. 2158, entitled *James Doneghy and St. Louis Union Trust Company, Residuary Trustees under Item 23 of the Last Will and Testament of James C. Doneghy, Deceased, Appellants,* v. *H. C. Jones, Collector of Internal Revenue, Appellee,* to the end that said causes and each of them may be reviewed and determined by this Court as provided by the statutes of the United States and that the judgments of said United States Circuit Court of Appeals in each of said cases be reversed by this Court, and that petitioners have such further relief as to this Court may seem proper.

Dated at Oklahoma City, Oklahoma, this 29th day of May, 1941.

JAMES DONEGHY AND ST. LOUIS UNION TRUST COMPANY, Residuary Trustees Under Item 23 of the Last Will and Testiment of James C. Doneghy, Deceased, Petitioners,

By CHAS. H. GARNETT,
608 Hales Building,
Oklahoma City, Oklahoma,
Attorney for Petitioners.

In the Supreme Court of the United States

OCTOBER TERM, 1941

NO. . . . . .

JAMES DONEGHY and ST. LOUIS UNION TRUST COMPANY, Residuary Trustees Under Item 23 of the Last Will and Testament of James C. Doneghy, Deceased,
Petitioners,

VERSUS

ACEL C. ALEXANDER, Formerly Collector of Internal Revenue,
Respondent.

NO. . . . . .

JAMES DONEGHY and ST. LOUIS UNION TRUST COMPANY, Residuary Trustees Under Item 23 of the Last Will and Testament of James C. Doneghy, Deceased,
Petitioners,

VERSUS

H. C. JONES, Collector of Internal Revenue,
Respondent.

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS OF THE TENTH CIRCUIT

BRIEF IN SUPPORT OF PETITION

I.

DECISIONS IN COURTS BELOW

These cases originated in the District Court of the United States for the Western District of Oklahoma. They are law actions which were triable by a jury, but in which

trial by jury was waived in writing and a trial had to the Court. The findings and decision of the trial court is not officially reported, but appears at pages 13 to 29 and 31 of the record.

The opinion of the Circuit Court of Appeals is reported in 118 Fed. (2d) 521, and appears at pages 111 to 115 of the record.

II.
STATEMENT OF THE CASE

A statement of the case containing all that is material to the consideration of the questions presented, with appropriate page references to the printed record, has been made in the petition for the writs herein and such statement is hereby adopted and made a part of this brief.

III.
ASSIGNMENT OF ERRORS

The petitioners make the following assignment of errors committed in the opinion and decision of the court below:

1. The Circuit Court of Appeals erred in that, after setting aside as clearly erroneous the finding of the trial court, that the 18⅛% beneficial interest in the Trust was a gift to the taxpayer, it did not remand the case to the trial court for further and corrected findings of fact or for other appropriate proceedings.

2. The Circuit Court of Appeals erred in that, after

setting aside as clearly erroneous the finding of the trial court that the 18⅛% beneficial interest in the Trust was a gift to the taxpayer, it did not remand the case to the trial court with directions to include the fair market value of that percentage of beneficial interest when acquired in the cost of his entire beneficial interest in the Trust and redetermine his loss on the sale of a part of that beneficial interest in 1930 and enter judgment accordingly.

3. The Circuit Court of Appeals erred in that after setting aside as clearly erroneous the findings of the trial court that the 18⅛% beneficial interest in the Trust was a gift to the taxpayer, it did not remand the case to the trial court for further proceedings, but instead made its own findings of fact upon a transcript of only a portion of the evidence and proceedings in the trial court and upon issues and questions not included in the trial court's findings and not passed on by the trial court, and upon its own findings based on such incomplete transcript affirmed the judgment of the trial court.

4. The Circuit Court of Appeals erred in holding that there was no proof in the record to sustain or support the taxpayer's claim that the 18⅛% beneficial interest in the Trust acquired by him in 1918 was in satisfaction of his claim against first the Doneghy Investment Company and then against the Trust as its successor, for compensation for services rendered by him under the contracts of February 23, 1904, and April 26, 1915, and in further holding that the record did not show for what consideration that additional beneficial interest was acquired, when the facts were

averred in the defendants' answers and admitted in the plaintiffs' replies that it was through an exchange of his share of the proceeds of the liquidation of the Doneghy Investment Company that he acquired the interest in the Trust held by him from April 26, 1915, throughout the year 1930.

5. The Circuit Court of Appeals erred in holding that the evidence before it in the transcript of a portion only of the evidence and proceedings upon the trial was sufficient to show that defendants had proven an estoppel against the plaintiffs which was not within the defendants' pleadings, and in affirming the judgment of the trial court on the basis of such estoppel when the trial court, with all the evidence and proceedings in the case before it, had found and held against such estoppel and the defendants as appellees had not filed a cross-appeal nor assigned any cross-error nor in any manner questioned the trial court's finding on the issue of an estoppel.

6. The Circuit Court of Appeals erred in holding that the evidence in the transcript of a portion only of the evidence and proceedings upon the trial brought up in the record before it was sufficient as a matter of law to support an estoppel of the plaintiffs to assert any cost to the taxpayer in the additional 18⅛% interest acquired by him in the Trust and in affirming the judgment of the trial court on the ground of such estoppel.

7. The Circuit Court of Appeals erred in that, after setting aside as clearly erroneous the finding of the trial court that the 18⅛% beneficial interest in the Trust was a

gift to the taxpayer, it proceeded, contrary to the uncontradicted evidence in the record that the right to receive that beneficial interest or its equivalent in value was earned by and had accrued to him prior to March 1, 1913, and was actually realized by him on liquidation of the Doneghy Investment Company in 1915, to find as a fact or to assume as a fact that said beneficial interest was a new acquisition to him in 1918 and its value was includable in his gross income for that year.

8. The Circuit Court of Appeals erred in not finding and holding that the right to receive the 18⅛% beneficial interest in the Trust or its equivalent in value was earned by and had accrued to the taxpayer prior to March 1, 1913, and hence was not subject to income tax, regardless of the year thereafter in which it was realized by him.

IV.

ARGUMENT

Synopsis of Argument

In support of the errors assigned the petitioners assert and rely on the following propositions which will be presented and considered in order:

1. The Circuit Court of Appeals, after rejecting the trial court's finding that the 18⅛% beneficial interest in the Trust was a gift to Doneghy, was bound either to remand the case for further and corrected findings by the trial court or, if it undertook to make its own findings, was

bound by facts averred and admitted in the pleadings and undisputed by anything in the record.

2. Estoppel is an affirmative defense and the burden of proving every essential element of it is on the one who asserts it and there is no evidence in this case that could under any view of the law support an estoppel against plaintiffs.

3. The property and rights in respect to property which Doneghy received on liquidation of the Company in 1915, comprising both compensation for services rendered and gain on his investment in stock in the Company, was not taxable income to him at any time, because his right to the compensation and the gain on his capital investment had accrued before and existed at March 1, 1913.

4. Under all the revenue acts compensation for services must be included in gross income, except where such compensation is the realization of a right to receive the same existing on March 1, 1913, and where services are paid for in property of any kind the fair market value of such property when received is the owner's cost basis therein for determining gain or loss on a sale thereof, and under the established facts in this case the decision and judgment of the Circuit Court of Appeals and of the trial court should be reversed by this Court with directions.

Proposition One

The Circuit Court of Appeals, after rejecting the trial court's finding that the 18⅛% beneficial interest in the Trust was a gift to Doneghy, was bound either to remand the case for further and corrected findings by the trial court or, if it undertook to make its own findings was bound by facts averred and admitted in the pleadings and undisputed by anything in the record.

These cases are actions at law in which trial by jury was waived in writing and the trial court undertook to make specific findings and to state separately its conclusions of law under the provisions of Rule 52(a) of the Federal Rules of Civil Procedure.

Just what power an Appellate Court has to reject findings of the trial court and make its own findings in a law case in which a jury is waived and the case tried to the court under the above rule is not clear. It probably is still the law, as it certainly was prior to the adoption of that rule, that in a law action tried to a jury or to the court without a jury the only matters open for review on appeal are (1) whether there was any evidence sufficient to support the trial court's findings and (2) whether the trial court's findings supported its judgment. The Appellate Court could not heretofore review the evidence and make its own findings independent of those of the trial court and either affirm or reverse the trial court upon its own fact findings. *McCaughn* v. *Real Estate Land Title Trust Co.*, 297 U. S. 606, 608; *State Farm Mut. Auto. Ins. Co.* v. *Coughran*, 303 U. S. 485, 487. In the latter case this Court said:

"Under applicable statutes and repeated rulings here, the matter open for consideration upon the appeal was whether the findings of the trial court supported its judgment. To review the evidence was beyond the competency of the court. 8 U. S. C. A., secs. 773, 875; *Walnut* v. *Wade*, 103 U. S. 683, 688, 26 L. ed. 526; *Stanley* v. *Bd. of Supervisors of Albany County*, 121 U. S. 535, 547, 7 S. Ct. 1234, 30 L. ed. 1000; *Law* v. *United States*, 266 U. S. 494, 496, 45 S. Ct. 175, 176, 69 L. ed. 401."

It is still settled law that a Circuit Court of Appeals is without power on review of proceedings of the Board of Tax Appeals to make any findings of fact and that the Board's findings of fact are conclusive, if there is evidence reasonably sufficient to support them.

Phillips v. *Commissioner*, 283 U. S. 589;

Burnett v. *Leininger*, 285 U. S. 136;

Helvering v. *Rankin*, 295 U. S. 123;

Gen. Utilities Oper. Co. v. *Helvering*, 296 U. S. 200;

Helvering v. *Kehoe*, 309 U. S. 277.

We know of no decided case holding that under said Rule 52 where the trial court has made specific findings the Appellate Court may not only reject those findings on the ground that they are not supported by the evidence, but also review the whole record and make its own findings of fact and base a decision affirming the trial court on its own findings.

In the instant case the trial court's finding that the 18⅛% beneficial interest in the Trust was a gift from the

other beneficiaries to Doneghy was not requested or suggested by either plaintiffs or defendants and was contrary to the pleadings and plainly was not the understanding and intention of those beneficiaries nor of Doneghy. The other beneficiaries when the contract of March 18, 1918, was entered into did not think they were making Doneghy a gift and he did not think he was receiving one. All of them intended to make and thought they did make a settlement and rearrangement of their several rights and interests in the property held by the Trust strictly according to the terms and provisions of their contracts dating back to February 23, 1904. So on the appeal both appellants and appellees agreed that the finding that this 18⅛% was a gift was wrong.

In passing it may be observed that the trial court's conclusion of law that the taxpayer had no cost basis in the 18⅛% because it was acquired by gift, was directly contrary to express statutory provision as well as the Treasury Regulations and an unbroken line of board and court decisions. Section 113(a)(4) of the Revenue Act of 1928; Art. 1562, Reg. 45; Art. 595, Reg. 74.

Obviously if the 18⅛% beneficial interest in the Trust was not a gift, there must have been a consideration for it. The Appeals Court said the taxpayer claimed it was compensation for services rendered but that there was "a complete absence of proof in the record to support or sustain" that claim and that the actual consideration might have been anything else, and what it was the record did not show (R.

114). On this statement that court bases one of its alternative grounds for affirming the trial court.

> Rule 52(a) provides that on appeal:
>
> "Findings of fact shall not be set aside unless clearly erroneous."

This empowers the Appellate Court to set aside erroneous findings of fact, but does not empower it to review the evidence and make its own findings of fact. Rightly interpreted it means that the Appellate Court can set aside erroneous findings of fact and remand the case to the trial court for appropriate proceedings to determine further and correct findings of fact.

Furthermore in the instant case only a partial transcript of the evidence and proceedings upon the trial (R. 42) was brought up in the record to the Appellate Court under the provisions of paragraphs (a), (d) and (e) of Rule 75 of the Federal Rules of Civil Procedure. The parties, or at least the appellants, deemed the part brought up sufficient to show the error of the trial court's judgment. On appeal they find that the error of the trial court is admitted and that the Appeals Court, after recognizing that error, proceeds to consider the partial transcript before it and to find and hold that the record fails to prove certain facts deemed essential to their case and does prove certain other facts not found by the trial court deemed fatal to their case.

> The defendant in each case in his answer averred:
>
> "That through an exchange of a share of the proceeds of the liquidation of Doneghy Investment Company plaintiff acquired the interest in J. C. Doneghy

> Trust held by him from April 26, 1915, until 1930, during which latter year the plaintiff sold a portion of his interest in the Trust."

In the reply of the plaintiffs to the answer of the defendant in each case it is said:

> "That they admit that it was through an exchange of his share of the proceeds of the liquidation of Doneghy Investment Company, including the portion of such proceeds distributed to him in compensation for services as above set forth, that J. C. Doneghy acquired the interest in the J. C. Doneghy Trust held by him from April 26, 1915, until 1930, in which year he sold a portion of his interest in said Trust."

We have here the specific allegation of defendants that all and whatever interest in the Trust was acquired by Doneghy was acquired by the exchange therefor of his share of the proceeds of the liquidation of the Company and the admission of this fact by the plaintiffs. In the light of this averment and admission no evidence was required to establish the fact as to how Doneghy came to acquire all the interest in the Trust that he ever had, nor would any have been admissible to show that the additional beneficial interest transferred to him in 1918 was acquired in any other manner or paid for from any other source. The plaintiff's contention that the 1918 contract merely changed the form of his interest in the Trust and did not give him any new acquisition is established by this pleading.

It is elementary that where a fact is alleged in the pleading of one party and specifically admitted in the pleading of the adverse party it is taken as true without the in-

troduction of evidence and is binding on the court as well as the parties. Indeed, the rule is further extended to the effect that an averment in a pleading to which a responsive pleading is required is deemed to be taken as true unless denied in such responsive pleading. Rule 8(d) of Federal Rules of Civil Procedure.

It would seem that the Appellate Court, even if it has become a fact-finding tribunal, when it does not have the whole record before it should remand the case for further proceedings in the trial court, in event that court's finding is set aside as erroneous.

Petitioners recognize the rule that if the decision below is correct, it must be affirmed on appeal, although the lower court relied upon a wrong ground or gave a wrong reason. But this rule has reference to errors of law where the facts are stipulated or are undisputed in the record or are found by the trial court upon sufficient evidence to support them. Such limitation of the rule is emphasized by the fact that it applies to the review of decisions of the Board of Tax Appeals whose fact findings are conclusive on the Circuit Courts of Appeals, if supported by any evidence. *Helvering* v. *Gowran,* 302 U. S. 238, 245-246. In the instant case the Appeals Court has set aside the fact finding on which the trial court based its decision, and then has affirmed that decision, not because the trial court gave the wrong reason for it, but upon a state of facts which it found or assumed from the incomplete record before it, and which the trial court did not find, but in part by necessary implication found adversely.

And if the Appellate Court has under Rule 52(a) become a fact-finding tribunal, then this Court, as the only court of review available, ought to review the question of whether there is any evidence in the record to support the findings of the Court. It is inherent in our judicial system that the findings of any fact-finding board, commission or tribunal should be subject to one review by an Appellate Court on the question of whether there is any evidence sufficient to support the facts found. This is an appropriate case for this Court to construe and apply Rule 52(a) and to settle the important question of federal law whether a Circuit Court of Appeals has the power to set aside an erroneous finding of the trial court and to proceed to make its own findings of fact on an incomplete record contrary to or different from those found by the trial court, or upon questions not passed on, and in respect of which no fact findings are made, by the trial court.

In any event the finding and holding of the court below that the record did not show how or for what consideration Doneghy acquired the 18⅛% beneficial interest in the Trust violates the settled and fundamental law that facts averred and admitted in the pleadings do not require proof and must be taken as true by the parties and the courts alike.

It would be an impertinence to present an array of authorities on this proposition.

In 21 R. C. L. 604, it is said:

"Proof is not required of an immaterial averment; of averments pleaded affirmatively by both parties;

of averments taken as confessed because of failure to deny them; or of facts otherwise admitted."

In *Wilcoxson* v. *Burton*, 27 Cal. 228, 87 Am. Dec. 66, it is held that a party is estopped by his pleadings from showing the averments therein contained to be untrue.

In *Landigan* v. *Mayer*, 32 Ore. 245, 51 Pac. 649, 67 A. S. R. 521, it is held to be error to admit evidence to dispute a material allegation that stands admitted by the pleadings.

A rather full discussion of the rule appears in *Pullman Co.* v. *Bullard* (5th C. C. A., 1930), 44 Fed. (2d) 347.

Without more we assert that the averment of a material fact solemnly made by a party in his pleadings and the truth thereof solemnly admitted by the adverse party in his pleadings is an established fact in the case. Not only is there no need to support it by evidence, but evidence offered in respect of it is not properly admissible. Nor can a court in its findings of fact disregard such admitted fact or make any finding contrary to it.

In the instant case the court below, assuming the function of the trial court as a fact-finding tribunal, and in the face of the contrary fact averred and admitted in the pleadings, said in reference to the 18⅛% additional interest in the Trust transferred to Doneghy that:

> "So far as the record speaks, he may have paid cash out of pocket for the increased interest, he may have exchanged property for it, or he may have acquired it in some other manner. The record does not tell, even sketchily, how it was acquired."

We respectfully assert that this statement, which is made the basis for that court's decision against petitioners on one of two alternative grounds, is flagrantly erroneous and in direct contravention of the admitted facts disclosed by the record. In basing its decision thereon, that court has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise by this Court of its power of supervision.

Proposition Two

Estoppel is an affirmative defense and the burden of proving every essential element of it is on the one who asserts it and there is no evidence in this case that could under any view of the law support an estoppel against plaintiffs.

Rule 8(c) of the Federal Rules of Civil Procedure enumerates the defenses which shall be set forth affirmatively in a pleading and estoppel is one of these.

In *Van Antwerp* v. *United States* (9th C. C. A., 1937), 92 Fed. (2d) 871, the Court, after stating that every essential element of an estoppel must be proven by the one relying on it, said:

> "These essential elements of estoppel, each of which the government must prove in this case, are set out in an authority cited in the government's brief:
>
> " 'To constitute estoppel (1) there must be false representation or wrongful misleading silence. (2) The error must originate in a statement of fact and not in an opinion or a statement of law. (3) The person claiming the benefits of estoppel must be ignorant of the true facts, and (4) be adversely affected by the acts or

statements of the person against whom an estoppel is claimed.'

U. S. v. *Scott & Sons* (C. C. A. 1), 69 Fed. (2d) 728, 732."

The following cases, all of which are tax cases, support this proposition and the above-cited case:

Helvering v. *Brooklyn City R. Co.* (2d C. C. A., 1934), 72 Fed. (2d) 274;

Salvage v. *Commissioner* (2d C. C. A., 1935), 76 Fed. (2d) 112;

Commissioner v. *Union Pac. R. Co.* (2d C. C. A., 1936), 86 Fed. (2d) 637;

Hull v. *Commissioner* (4th C. C. A., 1937), 87 Fed. (2d) 260;

Crossett Lbr. Co. v. *United States* (8th C. C. A., 1937), 87 Fed. (2d) 930;

Louis Werner Saw Mill Co. v. *Helvering* (Ct. App., D. C., 1938), 96 Fed. (2d) 539;

Helvering v. *Salvage* (1936), 297 U. S. 106;

McEachern v. *Rose* (1937), 302 U. S. 56.

While each of the foregoing cases fully sustains the proposition under consideration, the discussion in *Hull* v. *Commissioner* is particularly applicable here.

In the instant case the Appeals Court, after stating that if the taxpayer received 18⅛% beneficial interest in the Trust in 1918, it was his duty to show the value thereof as income on his return for that year, says:

"But he did not return any amount as such income

> in any year. His returns were consistently silent in respect of the matter, and limitation has long since run against correction of taxes arising out of the omission. Plaintiffs may not now take profitable advantage of such failure on the part of the taxpayer by asserting an increase in cost basis." (R. 115.)

The only fact in the record upon which that statement of fact and conclusion of an estoppel against the plaintiffs can be based is that Doneghy did not report as gain in 1918 the fair market value of the percentage of beneficial interest in the Trust which was transferred to him in that year. The only evidence in respect of his return for that year is the return itself (R. 87-89). Now if the apparent omission of the value of the beneficial interest in question from income on that return is a false representation, it was based on the taxpayer's interpretation of the law applicable. He contended then and ever after, and the plaintiffs contend now, that the value of this beneficial interest was not taxable gain or income to him in that year or in any year, but was merely a change in the form of his share in the assets of the Trust as fixed by the contracts of February 23, 1904, and April 26, 1915, to a percentage of beneficial interest in the corpus of the Trust, and that the rights he received in or in respect to the property of the Trust on liquidation of the Company in 1915 was his realization of earnings and capital gain which had accrued to him prior to March 1, 1913. This contention as to the law is supported elsewhere in this brief. And if he was in error in this view of the law, and if in fact the value of the percentage of interest in the corpus of the Trust acquired in 1918 should have been included in

income on his tax return, still there could be no estoppel against him, or the plaintiffs as his successors, based on his erroneous opinion of the law.

Furthermore, it does not appear that the Commissioner was ignorant of the true facts or acquiesced in the taxpayer's return in 1918 or was adversely affected by any omission of income on that return. The return as it appears in the record (R. 87) shows on its face that the Commissioner did not acquiesce in and accept it as filed, but that it was reviewed and audited and that some two years later additional tax in an amount four times as great as that shown and paid on the return was assesed against the taxpayer with a delay penalty.

In any event the burden was on the defendants to prove every essential element of an estoppel and the record is as silent as the tomb in respect of every element thereof other than the bald fact that the taxpayer's return for 1918 as filed did not purport to include any income realized by the acquisition of a further beneficial interest in the Trust.

In support of its holding the court below cites *R. H. Stearns Co.* v. *United States*, 291 U. S. 54; *Commissioner* v. *Farren* (10th C. C. A.), 82 Fed. (2d) 141; and *Alamo Nat'l Bank* v. *Commissioner* (5th C. C. A.), 95 Fed. (2d) 622.

An examination of *R. H. Stearns Co.* v. *United States* shows that its facts are so vastly different from those of the instant case that it cannot reasonably be said to have any application. There the taxpayer executed a waiver of limitation on assessment of taxes and delivered it to the Com-

missioner, and on the assumption that it was accepted by the Commissioner, received all the benefits of it. Then some six years after the whole matter had been closed, he sought to recover a refund of taxes on the ground that the waiver was void, because it had not been actually signed by the Commissioner. There could hardly be a stronger case of a taxpayer attempting to take advantage of the very thing he had procured the Commissioner to do for his benefit after he had reaped the benefits of it. There is nothing like that situation in the instant case.

In *Alamo National Bank* v. *Commissioner* the facts were that the taxpayer made return of the gain realized by him on liquidation of a corporation based on the value of certain assets distributed in kind and paid his tax accordingly. Then in a later year when he sold some of these assets, he sought to claim as his cost basis a larger value on them than he had claimed on his return in the year the corporation was liquidated. The Court properly held that he was estopped to do this. There is no similar fact situation in the instant case. In that case the Court cites, quotes and distinguishes *McEachern* v. *Rose*, *supra*, in which the rule here contended for was applied.

In *Commissioner* v. *Farren*, *supra*, and *Commissioner* v. *McCrary* consolidated with it, the facts were that certain corporate stock received by the taxpayers for services in the year 1918 had not been included at its market value in income on their returns. The Commissioner contended that they were estopped to claim any cost basis in this stock on the sale of it in a later year, because they had treated it as

having no market value in the year it was acquired. The Court based its decision in part on estoppel and in part on the proposition that the taxpayers had a cost basis in the stock when acquired different from its market value and that they had failed to prove this cost. In the opinion it is said:

> "The record here is silent as to cost; hence the taxpayer did not overcome the presumption that the Commissioner correctly computed the gain."

The writer of this brief was one of the attorneys for the respondents in the above cases. Petition for certiorari was applied for on the ground that the case was in conflict with the decision of the Second Circuit in the case of *Salvage* v. *Commissioner, supra,* which was affirmed by this Court in *Helvering* v. *Salvage, supra,* and with the decision of the Sixth Circuit in the case of *Robinson* v. *Commissioner,* 59 Fed. (2d) 1008. This Court granted certiorari. *Farren* v. *Commissioner,* 298 U. S. 653; *McCrary* v. *Commissioner,* 298 U. S. 653. After petitioner's briefs were filed and on August 11, 1936, Ellis N. Slack, an Assistant Attorney General of the United States, called the writer by telephone and said that, after having examined petitioners' briefs, the attorney general's office was doubtful that the decision of the Circuit Court of Appeals could be upheld, and suggested that we make an offer of settlement of the cases, and said that his office would recommend a settlement on the basis of 50% of the tax liability. After consultation with associate counsel and our clients an offer of 20% of the tax and interest in settlement was made. To this offer the attorney

general's office replied by telephone that a proposition to pay 25% would be accepted. We were averse to settling the case, because we were confident that the decision of the Circuit Court of Appeals was wrong and would be reversed, but our clients were afraid of the risk and preferred to protect themselves against a possible greater liability by settling on the 25% basis. So this settlement was agreed to and was carried out, and on October 26, 1936, the cases in the Supreme Court were: "Dismissed per stipulation of counsel." *Farren* v. *Commissioner*, 299 U. S. 617; *McCrary* v. *Commissioner*, 299 U. S. 617.

All communications from the attorney general's office in respect of this settlement were by telephone and the only writing signed by that office was the final stipulation of settlement. The taxpayers' liability turned upon a single and indivisible item and they owed all the tax in dispute or none. The settlement was a purely arbitrary one and the taxpayers merely purchased their release from the hazard of the cases by paying 25% of a possible liability in excess of $16,000 for each of them. The benefit to the Government was that it received 25% of a tax liability where it was entitled to nothing and that it had the benefit of the probably erroneous decision of the Circuit Court of Appeals as a precedent in its favor.

It is respectfully submitted that the Farren and McCrary decision is of doubtful value as a precedent and this Court could properly grant certiorari in this case for the purpose of settling the apparent conflict which still exists

between that decision and the Salvage and the Robinson cases and the others cited above on this proposition.

In income tax cases estoppel should be used sparingly and only where it is clearly established and its application will promote justice. In any instance its application violates the rule frequently announced and applied by the courts, including this Court, that income taxes are levied on the basis of an annual accounting period and income in one year should not be permitted to be transferred, either by the Commissioner or the taxpayer, to another year where it does not belong, for this will distort the income of both years and will subject the transferred income to the tax rate, whether higher or lower, of another year instead of to the rate applicable in the year in which it does belong. Errors of whatever nature in respect of income may properly be corrected only in the year in which they occur. *Newman* v. *Commissioner* (10th C. C. A.), 41 Fed. (2d) 743; *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301; *Aluminum Casting Co.* v. *Routzahn*, 282 U. S. 92; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375.

And if income accruing in one year may by the application of estoppel, and on no other ground than that it was erroneously omitted from taxation in the year in which it belonged and that taxing it in that year is barred by limitation, be transferred to and taxed in some other year, then that is an effectual repeal of the applicable statute of limitations. This Court in a series of cases, beginning with *Bell* v. *Morrison*, 1 Peters 351, 360, decided in 1828, and including *United States* v. *Oregon Lumber Co.*, 260 U. S. 290, decided

in 1922, has held and emphasized that the defense of the statute of limitations is not a technical one, but is as substantial and meritorious as any other.

Proposition Three

The property and rights in respect to property which Doneghy received on liquidation of the Company in 1915, comprising both compensation for services rendered and gain on his investment in stock in the company, was not taxable income to him at any time, because his right to the compensation and the gain on his capital investment had accrued before and existed at March 1, 1913.

It is settled law that compensation for services earned prior to March 1, 1913, and gain unrealized but consisting in an increment in value over cost in any form of property prior to March 1, 1913, is not subject to taxation under any of the income tax Acts, when realized in a later year. Such gains are capital of the holder of the right to the compensation and owner of the property and it does not matter when after March 1, 1913, the compensation for the services is actually paid in money or property and the increment of gain in the property is realized by a sale or other disposition thereof.

This fact has been recognized in all the Treasury Regulations. Article 87 of Regulations 45 as amended by T. D. 3206, 5 C. B. 116, provides as follows:

> "*Art.* 87. *Income accruing prior to March 1, 1913.* Any liquidated claim existing unconditionally on March 1, 1913, and then assignable, whether presently payable or not and held by a taxpayer prior to March 1, 1913,

whether evidenced by writing or not; and all interest which had accrued thereon before that date, do not constitute taxable income although actually recovered or received subsequent to such date. * * * Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued."

And Article 1548 of Regulations 45 as amended by T. D. 3206, 5 C. B. 46, provides as follows:

"*Art.* 1548. *Distribution in Liquidation.* So-called liquidation or dissolution dividends are not dividends within the meaning of the statute, and amounts so distributed, whether or not including any surplus earned since February 28, 1913, are to be regarded as payment for the stock of the dissolved corporation. Any excess so received over the cost of his stock to the stockholder constitutes income to such stockholder. However, if such stock was acquired prior to March 1, 1913, and the fair market value as of such date was greater than the cost but less than the amount so distributed, the taxable income is the excess over such fair market value of the amount received, but no gain is recognized if the amount received, although more than cost, is less than the fair market value of the stock on March 1, 1913."

Article 90 of Regulations 62 restates Article 87 of Regulations 45 as amended by omitting the words "and then assignable," but without other change. As thus restated this regulation has been incorporated in all subsequent regulations. Art. 90, Reg. 65; Art. 90, Reg. 69; Art. 91, Reg. 74; Art. 90, Reg. 77.

In *Lynch* v. *Turrish* (8th C. C. A., 1916), 236 Fed. 653, a corporation liquidated in March, 1914, and the question was whether the amount that stockholders received in liquidation in excess of their original investment in their stock was taxable income. All the value of the corporate assets in excess of its capital stock had accrued prior to March 1, 1913. The Court, in a full discussion of the subject and presentation of authorities, held that none of this gain to the stockholders was taxable, because it had in fact accrued prior to March 1, 1913. Certiorari was granted by this Court and the decision of the Circuit Court of Appeals affirmed in *Lynch* v. *Turrish*, 247 U. S. 221. Neither of the foregoing cases has been overruled, modified or criticised in respect of the holding on the point here involved.

The facts of the instant case bring it squarely within the regulations and cases cited. The value of the assets of Doneghy Investment Company was found by the trial court, and this finding is nowhere questioned, to be the same on March 1, 1913, as on April 26, 1915 (R. 27), when the Company was liquidated and all of its assets distributed in a liquidating dividend. Under his contract of 1904 Doneghy was entitled to 50% of all the profits accruing in the conduct of the Company's business. True, his share of these profits may not have been payable until realized by sales of the Company's property, but if it had liquidated at March 1, 1913, as it did at April 26, 1915, and distributed its assets in a dividend in kind, he would then have been entitled, as he was entitled in 1915, to 50% of all the distribution in excess of the $80,000 paid-in capital as compensation for

services and to his proportionate part of the remainder as a stockholder. It was the intention and understanding of the parties concerned that the Trust created by them was to and did take and hold the assets of the liquidated company on precisely the same terms and precisely the same interests of ownership and of rights in respect to those assets as existed when they were held by the Company. This meant that the Company's stockholders, including Doneghy, owned $80,000 and 50% of the excess in value of Trust assets over $80,000 in the same proportions that they had owned stock is the Company, and that Doneghy equitably owned the other 50% in excess of $80,000 which was to be paid over to him as the lands of the Trust were converted into money. If the agreement of March 18, 1918, had been made effective on April 26, 1915, Doneghy would then have received 81⅞% beneficial interest in the Trust and the other beneficiaries 18⅛% thereof. So when the agreement of March 18, 1918, was actually made, it merely put into effect the original agreement of February 23, 1904 (R. 43), between Doneghy and the Company, and expressed in a different form the agreement of April 26, 1915, as to the rights and interests of the parties in respect of the property transferred to the Trust at that time.

At least Doneghy consistently made the contention in 1918 and at all times thereafter, and petitioners make it now in good faith, that as a matter of law he realized no gain, acquired nothing that he did not own or have the right to before, by the agreement of 1918. If it should perchance be decided that this view of the law is wrong, even so there

is no authority for an estoppel against the taxpayer's claim that the value of his interest in the Trust in 1918 was his cost basis on the sale of it simply because he did not return such value as income in that year due to an honest mistake in the law.

On this point see the cases cited under Proposition Two, *supra.*

Proposition Four

Under all the revenue acts compensation for services must be included in gross income, except where such compensation is the realization of a right to receive the same existing on March 1, 1913, and where services are paid for in property of any kind the fair market value of such property when received is the owner's cost basis therein for determining gain or loss on a sale thereof, and under the established facts in this case the decision and judgment of the Circuit Court of Appeals and of the trial court should be reversed by this Court with directions.

A part of this proposition probably will not be disputed by respondents. The first clause is approved by the court below in its decision and is supported by Section B(1) of the 1913 Act, Section 2(a)(1) of the 1916 Act, Section 213(a) of the 1918 Act, paragraphs 52 to 54 of Regulations 33 Revised, and Article 31 of Regulations 45.

The rule that where services were rendered prior to March 1, 1913, but paid for thereafter, the compensation received is not taxable income except as to the excess of the amount received over the fair market value on March 1, 1913, of the claim for such compensation, has been established under Proposition Three, *supra.*

Within the Regulations there cited a claim exists unconditionally on March 1, 1913, when the claimant's right to it is certain, even though the value of it on that date must be estimated and the amount that may ultimately be realized from it may be either greater or less than such estimated value, depending upon fluctuations or contingencies subsequent to that date.

The statement that the fair market value of property received for services is the owner's cost basis therein is supported by the following, with nothing to the contrary:

Article 33 of Regulations 45;

J. Heninger et al., 9 B. T. A. 1318;

William T. Bivim, 21 B. T. A. 1051;

E. D. Knight, 28 B. T. A. 188, 189;

James H. Torrens, 31 B. T. A. 787, 795.

On the established facts that Doneghy acquired his interest in the Trust upon liquidation of the Doneghy Investment Company in 1915, which interest was changed in form only and without any new acquisition in 1918, and upon the fact that the interest so acquired in 1915 was compensation for services rendered and for increment in value of stock owned prior to March 1, 1913, this Court ought to reverse the Circuit Court of Appeals and the trial court and direct the trial court to recompute the loss sustained as set out in its conclusion of law No. 3 (R. 29) by fixing the taxpayer's cost in his interest in the Trust at 50% of the excess of $531,819.58 over $80,000 and 63¾% of the remainder, or at 63¾% of $80,000 out of said $531,819.58 and 81⅞% of the remainder, both of which give the same result.

CONCLUSION

In conclusion the petitioners say that under the only reasonable interpretation of the facts of this case as shown by the record the taxpayer has been denied the benefit of the deduction of a portion of his actual cost in his beneficial interest in the Trust in determining his loss upon the sale of a portion of such interest in 1930. Earnings and gains on his investment dating as far back as 1904 have been subjected to tax by the judgments of the district court and the Circuit Court of Appeals in the year 1930 in violation of settled principles of law under the Sixteenth Amendment and the various Revenue Acts.

The courts below have failed to understand or failed to recognize the simple and fundamental facts on which the taxpayer's case is based and have applied erroneous rules of law in the determination and in the interpretation and application of the facts.

In order that justice may be done to petitioners and for the reasons and upon the authorities set forth herein, petitioners ask that this Court grant the writs of certiorari as prayed for and review the decisions of the courts below.

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 119

JAMES DONEGHY AND ST. LOUIS UNION TRUST COMPANY, RESIDUARY TRUSTEES UNDER ITEM 23 OF THE LAST WILL AND TESTAMENT OF JAMES C. DONEGHY, DECEASED, PETITIONERS

v.

ACEL C. ALEXANDER, FORMERLY COLLECTOR OF INTERNAL REVENUE

No. 120

JAMES DONEGHY AND ST. LOUIS UNION TRUST COMPANY, RESIDUARY TRUSTEES UNDER ITEM 23 OF THE LAST WILL AND TESTAMENT OF JAMES C. DONEGHY, DECEASED, PETITIONERS

v.

H. C. JONES, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court of the United States for the Western District of Oklahoma

(R. 22–29) is not officially reported. The opinion of the Circuit Court of Appeals (R. 111–115) is reported in 118 F. (2d) 521.

JURISDICTION

The judgments[1] of the Circuit Court of Appeals were entered March 6, 1941 (R. 115–116). The petition for certiorari was filed June 2, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Circuit Court of Appeals erred in ruling that taxpayer's basis for determining gain or loss upon the sale in 1930 of a portion of his beneficial interest in a trust was not increased by reason of his acquisition of an additional interest in 1918.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 9–14.

STATEMENT

The facts as disclosed by the record and the opinion of the District Court (R. 22–29) may be summarized as follows:

Doneghy Investment Company was a corporation organized in 1904 under the laws of the Indian

[1] Both cases here involve the same question and were consolidated for trial in the District Court and for argument in the Circuit Court of Appeals. The cases were disposed of in a single opinion, with separate judgments (R. 115–116).

Territory for the purpose of dealing in lands and interests in lands in the Territory. Its authorized capital was $100,000, of which shares in the amount of only $80,000 were ever issued. J. C. Doneghy subscribed and paid for $51,000 of the stock, and four others subscribed for $29,000. Thus Doneghy became the owner of 51/80ths, or 63¾ percent of the outstanding shares, the others taking 29/80ths, or 36¼ percent. Upon its organization, Doneghy became president and manager of the corporation. The board of directors adopted resolutions vesting in him full authority to act in behalf of the company in the purchase and sale of lands. It was further provided that he was to receive no salary for his services, but was to be paid his actual expenses plus one-half of the net profits of all transactions (R. 42–43).

The corporation continued to deal in land investments until 1915. However, the constitution of Oklahoma, adopted in 1907, had in general prohibited corporations from holding title to farm lands within the State, and an act of the legislature had provided that corporations owning such lands (outside of cities and towns) should dispose of them within seven years from May 26, 1908. In order to comply with this statute, the stockholders of the corporation entered into a trust agreement dated April 26, 1915, providing that the corporation should convey all of its lands to Doneghy as trustee, and that he should dispose of them as soon as he deemed it to be to the best interests of the

parties. The agreement further provided that Doneghy should first deduct all his actual expenses, then deduct for his services one-half of the net profits from the sale of the lands and distribute the remainder to all the stockholders (including himself) in proportion to their stock ownership (R. 45, 23–24).

J. C. Doneghy continued to manage the lands under the trust agreement until it was modified by a supplemental agreement of March 18, 1918, which authorized him, as trustee, to continue selling the land and property as seemed to him for the best interests of the parties. The modified agreement further provided that he should deduct his expenses from the proceeds of sales and pay to the beneficiaries the sum of $80,000 (the amount originally invested in the stock of the Doneghy Investment Company) in the ratio of their previous interest in the corporation, and should then distribute the balance among the beneficiaries on the basis of 81⅞ [2] percent to Doneghy and the remaining 18⅛ percent proportionately among the others. Doneghy continued as trustee and manager of the property through the calendar year 1930, the tax period here involved (R. 47, 24–25).

Doneghy filed personal income tax returns regularly through 1930. He reported no capital gain or income upon the dissolution of Doneghy Invest-

[2] The 81⅞ percent figure is numerically equal to the sum, under the 1915 agreement, of Doneghy's 50 percent plus his 63¾ percent of the remaining 50 percent.

ment Company and distribution of its assets in 1915 (R. 27), nor did he report any gain for 1918 by reason of acquisition of an additional interest in the trust (R. 83–89, 27).

In 1930 J. C. Doneghy sold to his nephew, James Doneghy, an undivided one-fourth interest in the Doneghy trust, which was approximately 30.53 percent of his 81⅞ percent beneficial interest in the trust. The consideration which he received was $62,500 (R. 48, 62, 26). In his income tax return for 1930, Doneghy claimed to have sustained a loss of $31,850.96 by the sale of that portion of the trust interest. The loss was determined by taking $94,350.66 as the cost basis for the interest sold (R. 55, 61–62). Doneghy subsequently asserted that the loss was in fact even greater, and that by reason of mistake there had been an overpayment of the tax. The Commissioner, on the other hand, determined that the taxpayer had realized a gain upon which a deficiency tax was assessed. The determination was based upon a reduction of the taxpayer's cost basis for the beneficial interest which he acquired upon formation of the trust in 1915, and upon disallowance of any cost basis for the additional interest in the trust acquired under the supplemental agreement of March 18, 1919. The tax as finally determined by the Commissioner was paid, and separate claims for refund of the alleged overpayment and the asserted deficiency were submitted and rejected (R. 25–26).

All of the issues in the cases were decided by the District Court for the taxpayer, except that no cost was allowed for the acquisition in 1918 of the additional interest in the trust. The District Court found that the acquisition of the additional interest was without consideration on the part of the taxpayer and that it was in the nature of a gift or donation by the other beneficiaries under the trust (R. 27–28). The suits to recover the overpayment and to recover the deficiency were consolidated for trial in the District Court. In the former judgment was entered for the Collector for costs (R. 105–106), and in the latter for the taxpayer in the amount of $7,831.07, with interest (R. 32–33). The Circuit Court of Appeals affirmed the decision of the District Court (R. 115–116).

ARGUMENT

Under the 1915 agreement, Doneghy was to retain one-half of the net profits, after deducting expenses, and then to distribute the remainder to the beneficiaries in proportion to their stock ownership. And since Doneghy was a stockholder he would also receive 63¾ percent of the distribution of the remainder.

The 1918 supplemental agreement simply provided a different method for the distribution of the assets and profits among those beneficially interested. After deducting expenses, $80,000 was to be divided among the stockholders in accordance with their proportionate interests in the corpora-

tion; and the remainder was to be distributed, 81⅞ percent to Doneghy, and 18⅛ percent to the others proportionately.

The sole issue is whether the 1918 supplemental agreement operated artificially to increase Doneghy's cost basis in the enterprise. The court below correctly held that the 1918 agreement did not increase his basis. It merely established a different method of distributing the proceeds of the enterprises and did not increase Doneghy's capital investment which could be returned to him free of tax. The District Court found, contrary to petitioners' contentions, that Doneghy's consideration for his additional interest did not include any compensation already accrued in his favor under the 1915 agreement; and the court below concurred in that finding (R. 27–28, 114). True, the court below accepted petitioners' contention that the additional interest was not a "gift"; but that concession is entirely consistent with its conclusion that the consideration did not include compensation for *past* services. And, of course, to the extent that his apparent increase in the enterprise was merely in recognition of the *future* compensation that he would otherwise receive under the old agreement, it cannot serve to increase his basis. Cf. *Hort* v. *Commissioner,* No. 517, 1940 Term, decided March 31, 1941.

Petitioners' various contentions, which in essence charge the court below with ignoring the facts found by the District Court or those disclosed by

the pleadings, are without substance. The sole issue is whether, upon the undisputed facts, Doneghy was entitled to an artificially stepped-up basis, and the court below correctly ruled in the negative.

Nor is certiorari warranted on the so-called estoppel issue. The court did not rest its decision upon that ground. It simply indicated at the end of its opinion (R. 114–115), by way of dicta, that in any event, Doneghy was not entitled to an increased basis since he had not in fact reported any gain for 1918 with respect to the transaction which petitioners now urge as the foundation for a stepped-up basis.

CONCLUSION

The case turns on its own facts and no general question of federal law is involved. There is no conflict of decision and no sufficient reason for further review. The petition should therefore be denied.

Respectfully submitted.

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APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057:

SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; * * *

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit,

or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * *

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income);

* * * * *

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

(1) *Property held for productive use or investment.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

* * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(4) *Gift or Transfer in Trust before January 1, 1921.*—If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in section 402 (e) of the Revenue Act of 1921, or in section 302 (f) of the Revenue Act of

1924 or the Revenue Act of 1926 (relating to property passing under power of appointment) regardless of the time of acquisition;

* * * * *

(b) *Property acquired before March 1, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) the cost of such property (or, in the case of such property as is described in subsection (a) (1), (4), (5), or (12) of this section, the basis as therein provided), or

(2) the fair market value of such property as of March 1, 1913,

whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 561. *Determination of the amount of gain or loss.*—Section 111 sets forth the rules for the determination of the amount of gain or loss from the sale or other disposition of property. In general, the gain from the sale or other disposition of property is the excess of the amount realized therefrom over the cost or other basis provided in section 113 and articles 591–604, and the loss is the excess of such cost or other basis over the amount realized. Whether gain or loss from a sale or exchange shall be recognized, and if so, the extent to which it is to be recognized for the purpose of income taxation, must be determined under the provisions of section 112 and articles 571–580.

The amount realized from the sale or other disposition of property is the sum of any money received plus the fair market value of the property (other than money) received. The fair market value of property is a question of fact, but only in rare and extraordinary cases does property have no fair market value. In computing the amount of gain or loss, however, the cost or other basis of the property shall be properly adjusted for any expenditure, receipt, loss, or other item properly chargeable to capital account, including the cost of improvements and betterments made to the property since the basic rate and carrying charges, such as taxes on unproductive property. Where the taxpayer has elected to deduct carrying charges in computing net income, or used such charges in determining his liability for filing returns of income for prior years, the cost or other basis may not be increased by such items in computing the gain or loss from the subsequent sale of the property. The cost or other basis of the property must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion which have since the acquisition of the property been allowable in respect of such property, whether or not such deductions were claimed by the taxpayer or formally allowed. Adjustment to the cost or other basis on account of such allowable deductions as distinguished from the deductions actually taken in prior years, will be made only upon the basis of explicit and convincing evidence (and calculations based upon a theoretical formula are not such evidence) that the deductions taken were insufficient or excessive, as the case may be, due regard

being given to the expenditures made by the taxpayer to maintain the effective usefulness of the property. In no case shall the amount of the diminution in respect of depletion exceed a depletion deduction computed without reference to discovery value in the case of mines, or without reference to the allowance for depletion provided by section 114 (b) (3) in the case of oil and gas wells. See articles 241 and 611.) In addition, if the property was acquired before March 1, 1913, the basis (if other than the fair market value as of March 1, 1913) must be diminished by the amount of exhaustion, wear and tear, obsolescence, and depletion actually sustained before that date. In the case of stock the basis must be diminished by the amount of distributions previously made in respect to such stock, to the extent provided under the law applicable to the year in which the distribution was made.

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